BOOK REVIEWS

Railroad Reorganization. "Harvard Economic Studies," Vol. IV. By STUART DAGGETT. Boston: Houghton, Mifflin & Co., 1908. 8vo, pp. x+402.

This four-hundred-page work is the result of an investigation extending over a period of several years, during which the author collected, classified, and carefully studied the facts concerning a large number of railroad reorganizations. Nine chapters are devoted to the study of the reorganization of some of the greatest railroad systems in this country, including the Baltimore and Ohio, the Erie, the Philadelphia and Reading, the Southern, the Atchison, the Union Pacific, the Northern Pacific, and the Rock Island. This portion of the volume is designed to furnish materials for a study of reorganizations according to the case system and is well adapted to that purpose. Taking up each of the above-named railroad systems in turn, the author treats them historically, dealing more particularly with the methods pursued in expanding these systems, and the methods of financing these expansions as well as other financial operations, all of which throw light on the manner in which occasions for financial readjustments arise. In describing the reorganizations themselves it is to be regretted that the author could not go into much greater detail, describing the main lines, the branch systems, the sub-branches, listing and grading the securities of each according to the priority of their liens upon the properties covered, showing the rank of various interest or rental guaranties as compared with other obligations of the parent and constituent companies, the earning power of each, and then show the effect of all of these influences upon the plan of reorganization as formulated. Unfortunately, this cannot, in most cases, be done, especially that part relating to the earning power of constituents. The determination of these earnings is largely a matter of accounting, the data for which is in possession only of the railroad company. Yet it is data which should be in the hands of every security holder who is involved in a reorganization. The author has done as well, probably, as is possible under the circumstances. The material contained in this portion of the volume will be found

valuable for case work by college students as well as for the investor who wishes to inform himself concerning practice in reorganizations.

The tenth and concluding chapter constitutes a general treatment of railway reorganizations in which are framed rules and general principles deduced from the preceding study. The author defines a "reorganization" as denoting

> the exchange of new securities for the principal of outstanding immatured general mortgage bonds or for at least 50 per cent of the immatured junior mortgages of any company, or for the whole of the capital stock.

This definition enables the author to include in his study of reorganizations not only those readjustments occasioned by financial embarrassments, but also such an adjustment as that of the Atchison in 1892 in which a second mortgage income bond issue was converted into a larger second mortgage bond issue with a fixed interest, the object of which was to enable the company to sell more bonds; as that which occurred in 1880 when the old Chicago, Rock Island and Pacific Railway Company was consolidated with several of its subsidiaries to form the present Railway Company, an operation in the course of which the stock capital of the system was considerably augmented; and even the financial manipulation of the Rock Island system in 1902 transferring the ownership of most of its stock from individuals to another corporation. We doubt the advisability of including all these types in one study since they present different problems whose solution is governed by totally different principles, at least their treatment should be kept separate. However they are all included—and the author's discussion of the Rock Island manipulation makes interesting reading.

Outside of a single chapter in Greene's *Corporation Finance,* the only earlier general discussion extant of the reorganizations of insolvent railroad companies is a monograph on that subject by Dr. E. S. Meade of the University of Pennsylvania. (Published in and reprinted from *The Annals of the American Academy of Political and Social Science,* March, 1901.) This was also the result of the study of a large number of actual reorganizations and thoroughly covers all of the important problems involved in such reorganizations. As is to be expected, these two works cover practically the same ground and in most cases agree in results. The earlier work contains some valuable matter not found in the later, such as a

description in some detail of the methods of forming bondholders' protective committees, and omits some material found in the later work, such as the effects of reorganization upon the capitalization of the railroad system.

In the formulation of one important principle, namely, that governing the distribution of interest losses among the various security holders, we consider Dr. Meade's statement to be more happy than that of our author. The latter puts it thus, after explaining the significance of the successive liens upon the same piece of property:

> The principle of reorganization which is followed prescribes because of this the payment in full of all claims which can be satisfied by the purchase price of the bankrupt railroad at foreclosure sale; and the distribution of losses among the remainder according to the relative priority of their liens.

The reader is apt to imply from this that the test is to estimate for how much the road would sell under foreclosures of say, the first mortgage, apportion this among the several bond issues in order of their seniority and see which would be left partly or fully unpaid, the interest losses to fall on the latter. The earlier discussion of this point proceeds as follows:

> What bonds shall be disturbed, in what way shall their claim be reduced? In every reorganization we find some of these bonds. These bonds are passed by in the reorganization for the reason that their interest, even in worst years, has been fully earned.

In other words, the principle is that the interest claim of a particular bond issue must be reduced to such a point that it will not exceed the income available for its payment. The reader is apt to think that these are the two ways of saying the same thing. That there is an important difference is evidenced by the following illustration. The A. B. R. R. Co. has a first mortgage issue of $10,000,000, bearing 7 per cent. interest, a second mortgage issue of $5,000,000 bearing 5 per cent., and $10,000,000 of capital stock; its earnings after paying operating expenses and taxes are $800,000, sufficient to pay all the interest on the first mortgage issue and $100,000 or two-fifths of that of the second mortgage bonds. Assume that at foreclosure sale the road could be sold at $16,000,000 ($800,000 capitalized at 5 per cent.). Following literally the rule laid down by our author, this would be sufficient to pay off both bond issues in full and $100,000 to the stockholders. Apparently the only losers would be the last named. But let us see. The

first mortgage bond holders, receiving $10,000,000 would have to reinvest it; they probably could not get more than 5 per cent. on that amount, as compared with the 7 per cent. which they had been getting before; they have lost 2 per cent. Or, they obtain only $10,000,000 for bonds for which, probably, they paid a high premium. From either viewpoint, the first mortgage bondholders lose. The second mortgage bondholders, who were obtaining only 5 per cent. in the first place, re-invest their $5,000,000 at 5 per cent., and lose nothing. This, apparently, is the way in which our author's principle would work. In practice the reorganization committee would reason as follows. It requires $700,000 to pay the interest on the first mortgage bonds; the available earnings are $800,000; this interest has been fully earned, should be fully paid, and the bonds should not be disturbed. This leaves $100,000 available for payment of the second mortgage bond interest, as compared with a requirement of $250,000. The bonds must, therefore, be exchanged for new securities in such a way that the fixed interest requirements of the latter shall not exceed $100,000. This can be done by issuing $5,000,000 of new 2 per cent. bonds, or $3,500,000 of new 4 per cent. bonds, or $2,000,000 of new 5 per cent. bonds and so on. In other words, the governing principle is the amount of income available for the payment of the interest on the bond issue in question. Often, as in the case of a branch line which interchanges traffic with the main line the determination of this income is a very difficult and complex accounting problem, a problem which causes some receiverships to be long drawn out. The same principle, of course, applys to the reduction of rentals, for these are but an earlier stage of interest and dividends on leased line bonds and stocks, and are based upon the earning power of such lines.

Outside of this seeming inaccuracy of statement, the author's concluding chapter is an able treatment of the subject. It includes a discussion of the causes of receiverships, a statement of the problems involved in a reorganization, and the methods of solving them, the simplification of the systems of bond issues, the methods of compensating security holders for the losses of fixed income which they sustain, the functions of the underwriting syndicate, and the purposes and duration of voting trusts. The author sees that assessments upon junior security holders are practically sales of new stock at prices which could not be realized if such stock were

offered for voluntary subscription, accomplished by offering them as a bonus chance to recoup their losses in the future. The work should be of great aid to the investor who is involved in any of the current reorganizations, as well as an important source of materials for class-room study.

THOMAS WARNER MITCHELL

UNIVERSITY OF PENNSYLVANIA

A History of Transportation in the Eastern Cotton Belt to 1860. By ULRICH BONNELL PHILLIPS. New York: Columbia University Press, 1908. Pp. xviii+405.

There is no more interesting or important phase of American economic history than is presented by the origin and development of transportation. The history of highways, canals, and railroads in the South before the Civil War had received little attention before Professor Phillips took up the study, although the unique economic organization of the South and the comparative industrial isolation of that section of the United States had long impressed all students. One can easily share some of the enthusiasm that causes Professor Phillips to say: "To me the *antebellum* South is the most interesting theme in the history of this continent."

The present volume is concerned almost entirely with the development of transportation in South Carolina and Georgia. North Carolina and Alabama were omitted because a history of internal improvements in those states had been written by C. C. Weaver and W. E. Martin and published in the Johns Hopkins University "Studies." After an introduction of twenty pages giving a general survey of the transportation problems in the South, Professor Phillips devotes two chapters to highway and canal development in lowland and upland South Carolina prior to 1830. Then follow accounts of the Charleston and Hamburg Railroad and the premature Charleston project, the Georgia Railroad and Banking Company, the Central of Georgia system, the Western and Atlantic (built by Georgia) and various minor branch roads. The concluding chapter describes the beginning made during the five years before the war in the integration and co-operation of the hitherto independent roads, and summarizes the effects of the railways upon social and economic organization.

The southern states, cities, and counties gave large aid to practically all of the railroad companies that constructed lines before